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12

13
14 SUPERIOR COURT OF THE STATE OF CALIFORNIA
15 COUNTY OF LOS ANGELES
16

17 ANTHEM, INC., an Indiana
corporation,

18 Plaintiff,

19 vs.

20 JOHN GARAMENDI, in his capacity
21 as INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA;
22 THE CALIFORNIA DEPARTMENT
OF INSURANCE; and DOES 1 through
23 100, inclusive,

24 Respondents and
Defendants.
25

CASE NO. BS091601

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
DEMURRER TO PETITION AND
COMPLAINT**

Date: October 5, 2004
Time: 9:30 a.m.
Dept: 85
Judge: Honorable Dzintra Janavs

ORIGINAL FILED

AUG 25 2004

LOS ANGELES
SUPERIOR COURT

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INTRODUCTION

Respondent and defendant John Garamendi (the “Commissioner”), exercising his statutory authority, denied the application of petitioner and plaintiff Anthem, Inc. (“Anthem”) to acquire control of BC Life & Health Insurance Company (“BC Life & Health”) as part of a merger of WellPoint Health Networks Inc. (“WellPoint”) into Anthem. Relying on Insurance Code Sections 1215.2(d)(3) and (4), the Commissioner concluded that the payment of some \$200 million to \$600 million in “golden parachute” compensation to Anthem and WellPoint’s executives through the merger, and the servicing of approximately \$3.4 billion in debt created by the merger, would prejudice the interests of BC Life & Health’s policyholders and would not be fair and reasonable to them.

Dividends from BC Life & Health and other WellPoint subsidiaries to Anthem are the sole source of funds to repay the multi-billion dollar debt created by the merger, and Anthem provided no adequate assurance that BC Life & Health’s policyholders would not also end up subsidizing the excessive payments to Anthem and WellPoint’s corporate executives. The dividends from BC Life & Health to fund the enormous debt and executive compensation created by the merger, in turn, will come from premium payments higher than they would be in the absence of the merger, reduced benefits, and increased co-pays imposed on BC Life & Health’s policyholders, all to their prejudice.

The sole issue raised by Anthem’s petition is a narrow and straightforward legal one - does the Commissioner have the legal authority to consider the potential impact on policyholders of the enormous debt and executive compensation created by the acquisition of control. Anthem asserts that once the Commissioner determined that BC Life & Health’s financial condition would not be jeopardized by the acquisition, his inquiry was over, and the Commissioner was required to approve the transaction. Pet. ¶¶ 29, 37. Under Anthem’s theory, so long as BC Life & Health is solvent after the

1 merger, the Commissioner could not object to the transaction even if policyholder
2 premiums had to be doubled to pay for the transaction.

3 The Commissioner's statutory authority is not so limited. Both on its face
4 and in accordance with the policyholder protection purpose of the statute, Insurance Code
5 Section 1215.2(d)(3) and (4) give the Commissioner broad authority to consider those
6 matters affecting BC Life & Health policyholders that he took into account in denying
7 Anthem's application. The Kansas Supreme Court has recently upheld broad insurance
8 regulatory authority over merger approvals in a case very similar to this one and which
9 also involved a proposed Anthem acquisition. *Blue Cross and Blue Shield of Kansas, Inc.*
10 *v. Praeger*, 75 P.3d 226 (Kan. 2003). The legal issue of the scope of the Commissioner's
11 authority can be resolved on demurrer. *StorMedia, Inc. v. Superior Court*, 20 Cal.4th 449,
12 455, n.7 (1999).¹

13 Anthem also obliquely asserts that its constitutional equal protection rights
14 were violated, because the Commissioner "ordinarily" only looks at the adequacy of the
15 surviving company's capital in assessing whether to approve a merger. Pet. ¶¶ 44-45.
16 That argument, too, must fail as a matter of law. The Commissioner had a rational basis
17 for considering the potential effect on policyholders of excessive executive compensation
18 and multi-billion dollar debt service obligations, whether or not those factors were
19 prominent in his review of other merger transactions. That disposes of Anthem's equal
20 protection claim.

21 Anthem's petition notwithstanding, the Commissioner's function is not to
22 rubber-stamp transactions that meet minimum financial reserve or surplus requirements.
23 Instead, he serves to broadly protect insurance policyholders from deals that are not fair
24 and reasonable and that may prejudice them, in whatever form that prejudice or unfairness
25 exists.

26
27 ¹ Pursuant to Code of Civil Procedure Section 1089, the Commissioner is filing an
28 answer to the petition concurrently with this demurrer.

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1 the acquiring person plans or proposes to make any major change in the insurer's business
2 or corporate structure or management that is "not fair and reasonable to policyholders."
3 After reviewing the proposed transaction, the Commissioner determined that major
4 changes in BC Life & Health's business and corporate structure were likely to occur after
5 the merger, and that such changes were not fair and reasonable to BC Life & Health's
6 policyholders and would prejudice them. Ex. A, p. 2.

7 More specifically, the Commissioner found that the merger would require
8 nearly \$4 billion in cash in order for it to be consummated, that debt of approximately
9 \$3.4 billion would have to be repaid by Anthem, and that policyholders of the companies
10 being acquired, including BC Life & Health, would be paying this debt. Ex. A, p. 2.
11 Indeed, Anthem acknowledged that dividends paid by WellPoint's health care
12 subsidiaries, including BC Life & Health, are the only source of funds to repay that debt.
13 *Id.*

14 The Commissioner noted that WellPoint has a decade-long history of up-
15 streaming large dividends from its subsidiaries, including BC Life & Health. Ex. A, p. 3.
16 Although Anthem offered to limit increases in dividends from the California subsidiaries
17 for three years, BC Life & Health could still up-stream at least \$330 million to Anthem
18 over that time. *Id.* Significantly, after three years, even these limitations would be
19 removed. *Id.* These enormous dividends to the parent company were possible, the
20 Commissioner found, because of "the large profits earned during the last several years of
21 double-digit health care premium inflation, benefit reductions and increased co-pays." *Id.*
22 The merger, the Commissioner concluded, creates an even greater need to upstream
23 profits to the parent, and it was therefore prejudicial, unfair and unreasonable to
24 policyholders. *Id.*

25 The Commissioner also found that a significant amount of the dividends to
26 be paid by WellPoint's subsidiaries, including BC Life & Health, might be used to pay
27 executive compensation packages ranging from \$200 million to \$600 million. Ex. A, p. 3.
28 Although Anthem attempted to ensure that the executive compensation would not be paid

1 by California companies, the Commissioner was not convinced that such subsidization by
2 BC Life & Health would not occur. *Id.* Such executive compensation subsidies, the
3 Commissioner concluded, would prejudice BC Life & Health's policyholders, who would
4 finance these subsidies through higher premiums and reduced benefits. *Id.* Accordingly,
5 he found that the excessive severance obligations from management changes that the
6 merger created were not fair and reasonable to BC Life & Health policyholders. Ex. A,
7 pp. 3-4.

8 Finally, the Commissioner also balanced the very substantial costs the
9 merger would impose on policyholders against the purported benefit to them of the
10 merger. He determined that the claimed benefits from the merger were extremely modest
11 and were ones that might well be achieved through a more efficient operation of the
12 unmerged entities. Ex. A, p. 4. These benefits, the Commissioner concluded, did not
13 justify the substantial acquisition costs that policyholders would bear. *Id.*²

14 **I. THE INSURANCE CODE GIVES THE COMMISSIONER BROAD**
15 **DISCRETION TO CONSIDER WHETHER PROPOSED TRANSACTIONS**
16 **PREJUDICE AND ARE UNFAIR AND UNREASONABLE TO**
17 **POLICYHOLDERS**

18 **A. The Statutes, By Their Terms, Give The Commissioner Broad**
19 **Authority**

20 The Commissioner denied Anthem's application pursuant to Insurance Code
21 Sections 1215.2(d)(3) and (4). Those sections are part of the Insurance Holding Company
22 System Regulatory Act, Insurance Code Sections 1215 et. seq. Anthem contends that
23 once the Commissioner found that it "has adequate capital to conduct its business after the
24 acquisition is complete" and that "BC Life & Health's financial condition would not be
25 jeopardized by the merger," his statutory duty of inquiry ended and he had no authority to
26 deny Anthem's application. Pet. ¶ 33. As a corollary to that contention, Anthem asserts
27 that the uses it will make of dividends paid to it by BC Life & Health after the merger are

28 ² The Commissioner also found that the merger would diminish competition for
nationally available health products, and that this anti-competitive effect would ultimately
have a negative impact on California markets and was not fair and reasonable to
policyholders. Ex. A, p. 4.

1 none of the Commissioner's business and are not unlawful under other statutes. Pet.
2 ¶¶ 34-37. That is *not* what the statute says.

3 Section 1215.2(d)(3) permits the Commissioner to disapprove a transaction
4 if he finds that the acquiring person's financial condition is such as "*might* jeopardize the
5 financial stability of the insurer, *or* prejudice the interests of its policyholders." The
6 statute is written in the disjunctive. It should be interpreted as written, giving effect to
7 every word if possible, including the word "or." *State Farm Mutual Automobile Ins. Co.*
8 *v. Garamendi*, 32 Cal.4th 1029, 1043 (2004); *Barker Bros., Inc. v. Los Angeles*, 10 Cal.2d
9 603, 606 (1938) ("function of the word 'or' is to mark an alternative such as 'either this or
10 that'"). Accordingly, even if the transaction would not jeopardize the financial stability of
11 the insurer, the statute allows the Commissioner to determine if it might otherwise
12 prejudice the interests of the insurer's policyholders. Anthem's interpretation, however,
13 would read this alternative basis for disapproval out of existence.

14 Nor does disallowance require a finding that the transaction "would"
15 prejudice the interests of policyholders. Instead, the Commissioner need only find that it
16 "might" have that effect. The word "might" means "a possibility or probability weaker
17 than *may*." Webster's II New College Dictionary 694 (1995). See *Bonds v. Bonds*, 24
18 Cal.4th 1, 15-16 (2000) (words in statute should be given their ordinary, dictionary
19 meaning); *Koch v. Koch Industries, Inc.*, 969 F.Supp. 1460, 1492 (D. Kan. 1997) ("might"
20 refers to something that could, but not necessarily would, happen).³

21 Here, the Commissioner found that BC Life & Health would, with other
22 WellPoint subsidiaries, be responsible for paying the multi-billion dollar debt created by
23 the merger transaction. Ex. A, pp. 2-3. Those payments would prejudice BC Health &
24 Life policyholders, whose health insurance premiums would increase and whose health
25 insurance benefits would decline as a result. *Id.* Similarly, the Commissioner found that
26 policyholders might end up financing huge corporate executive payments required by the

27 ³ A copy of the *Koch* case is included in the Appendix of non-California authorities
28 filed with this Memorandum.

1 merger.

2 Under Anthem's reading of the statute, so long as the insurer remains
3 solvent after the merger, the acquiring company can loot it to pay transaction costs that
4 policyholders will bear without any corresponding benefit. The statute does not so limit
5 the Commissioner's authority, and he is permitted to examine and weigh the detriment to
6 policyholders that might result from the transaction.

7 Section 1215.2(d)(4) also authorized the Commissioner to disapprove the
8 Anthem transaction. Under that section, the Commissioner can disapprove if the
9 acquiring person has plan or proposals to make any major change in the insurer's
10 "business or corporate structure or management" that are not fair and reasonable to
11 policyholders. BC Life & Health has up-streamed its dividends to its parent, WellPoint,
12 before. Ex. A, p. 3, But the up-stream payment of BC Life & Health's dividends, with no
13 limitation after three years, to finance Anthem's enormous merger debt is a major change
14 in BC Life & Health's business. The Commissioner could reasonably conclude that such
15 dividend payments, with the attendant rise in premiums and reduction in benefits to
16 policyholders, was not fair and reasonable to them.

17 Similarly, there are major changes in management that will result from the
18 merger, and those changes will trigger massive "golden parachute" payments that the BC
19 Life & Health policyholders may finance. Again, the Commissioner could reasonably
20 conclude that these excessive severance payments are not fair and reasonable to
21 policyholders. Clearly, the statute permitted him to make that assessment.

22 **B. The Commissioner's Broad Authority To Protect Policyholders Is**
23 **Consistent With The Public Policy Used To Interpret Insurance Laws**

24 If there is any doubt about a statute's meaning, it should be construed in a
25 manner that achieves its objective. *County of Santa Clara v. Perry*, 18 Cal.4th 435, 442
26 (1998); *People v. United National Life Insurance Company*, 66 Cal.2d 577, 595-596
27 (1967). Courts may consider the effect of a statutory interpretation on public policy
28 (*People v. Smith*, 32 Cal.4th 792, 798 (2004)), and should broadly construe legislation that

1 is intended to protect the public to effectuate its purpose. *Lovejoy v. AT&T Corporation*,
2 119 Cal.App.4th 151, 159 (2004). Although the Court will ultimately determine the
3 meaning of a statute, “great weight” ought to be given to the construction of the statute by
4 the official responsible for its administration. *Harrott v. County of Kings*, 25 Cal.4th
5 1138, 1154-1155 (2001).

6 The business of insurance is “‘clothed with a public interest’ and therefore
7 subject ‘to be controlled by the public for the common good.’” *20th Century Ins. Co. v.*
8 *Superior Court*, 90 Cal.App.4th 1247, 1265 (2001). Indeed, insurance “so greatly affects
9 the public interest that the industry is viewed as a ‘quasi-public’ business, in which the
10 special relationship between the insurers and insureds requires special considerations.”
11 *Id.* Insurers therefore “must take the public’s interest seriously, where necessary placing
12 it before their interest in maximizing gains and limiting disbursements.” *Id.*

13 The scope of the Commissioner’s authority to approve the acquisition of an
14 insurance company should be assessed in light of the public protection that underlies
15 insurance law. The Kansas Supreme Court, in a case remarkably similar to this one and
16 which also involved Anthem, has so held.

17 In *Blue Cross and Blue Shield of Kansas, Inc. v. Praeger*, 75 P.3d 226, the
18 Kansas Supreme Court upheld the denial by the state’s insurance commissioner of
19 Anthem’s application to acquire Blue Cross & Blue Shield of Kansas (“BCBS”).⁴ Upon
20 acquisition, Anthem planned to raise premiums on policyholders and reduce BCBS
21 surplus. 75 P.3d at 233. The surplus would nevertheless have remained above the
22 minimum required by Kansas law. 75 P.3d at 235.

23 The commissioner determined that even though Anthem met the surplus and
24 other requirements of Kansas insurance law, satisfaction of those requirements did not
25 mean that the transaction was in the interests of BCBS policyholders and must be
26 approved. To the contrary, relying in part on a statute similar to the one at issue here, the

27 ⁴ A copy of this case is included in the Appendix of non-California authorities filed
28 with this Memorandum.

1 Commissioner concluded that the transaction would impose additional financial burdens
2 on BCBS policyholders that were unfair and unreasonable, and that the transaction should
3 therefore be disapproved. 75 P.3d at 242.

4 The Kansas statute governing the commissioner's review of the transaction
5 included a provision almost identical to California Insurance Code Section 1215.2(d)(4) –
6 i.e. permitting disapproval where the acquiror's plans and proposals are unfair and
7 unreasonable to policyholders. 75 P.3d at 237. The statute also permitted disapproval if
8 an acquisition was "likely to be hazardous or prejudicial to the insurance-buying public."
9 *Id.*

10 The Kansas Supreme Court held that these statutes gave the commissioner
11 broad authority to evaluate proposed acquisitions of insurers. Contrary to Anthem's
12 argument, the fact that surplus or premium rate requirements would be met did not equate
13 to operating in the interests of policyholders or mandate approval of the transaction. 75
14 P.3d at 241. According to the Court, Anthem's interpretation would "unnecessarily
15 dilute[] the Commissioner's discretion in the acquisition statute." *Id.*

16 Like *Praeger*, the Commissioner has reviewed the proposed transaction and
17 concluded that the transaction would be unfair and unreasonable to BC Life & Health's
18 policyholders. Also, as in *Praeger*, Anthem's argument that the transaction here must be
19 approved because Anthem will have adequate capital to conduct its business or satisfies
20 other laws ignores critical statutory language, ignores the public interest underlying the
21 California statute, and unduly restricts the Commissioner's discretion in evaluating
22 proposed acquisition transactions.

23 **C. The Approval Of The Transaction By Other Regulators Does Not**
24 **Diminish The Commissioner's Authority**

25 Anthem notes that regulators in other states have approved the transaction.
26 Pet. ¶ 15. Such approval is beside the point, however, in determining whether the
27 Commissioner had the statutory authority to act as he did here. The Commissioner serves
28 to enforce the California statute and, to that end, undertakes his own independent

1 examination of the proposed transaction. He is not required to approve the transaction
2 because a regulator in Georgia or West Virginia has done so.

3 Nor does the approval of the transaction by the Department of Managed
4 Health Care ("DMHC") affect the Commissioner's oversight of the transaction. Under
5 the Knox-Keene Health Care Service Plan Act of 1975, Health & Safety Code Sections
6 1340 et. seq., the DMHC regulates health care and specialized health care service plans,
7 including BCC. Pet. ¶ 20. Putting aside the limits on that agency's review of transactions
8 like the Anthem one, the DMHC does not regulate insurers such as BC Life & Health.
9 The Commissioner does. That agency's review of the transaction simply does not inform
10 the scope of the Commissioner's review under Insurance Code Sections 1215.2(d)(3) and
11 (4).

12 **II. THE COMMISSIONER HAD A RATIONAL BASIS FOR DENYING**
13 **ANTHEM'S APPLICATION, AND ANTHEM'S EQUAL PROTECTION**
14 **CLAIM MUST FAIL**

15 Anthem alleges on information and belief that in denying its application, the
16 Commissioner has applied different standards to Anthem than it applied to other
17 applicants. Pet. ¶ 44. Anthem bases that allegation on three things: (1) the
18 Commissioner's statement that "ordinarily" his review of a transaction would end once he
19 determined that the surviving company has adequate capital to conduct its business; (2)
20 the Commissioner applied "factors extraneous to Cal. Ins. Code § 1215.2" in denying
21 Anthem's application; and (3) the Commissioner failed to explain why this was not a
22 "typical" transaction. Pet. ¶¶ 44-45.

23 From this, Anthem asserts that the Commissioner's disparate treatment of
24 Anthem's application was "intentional" and had no rational basis under Insurance Code
25 Section 1215.2. Pet. ¶ 46. Anthem's equal protection claim must fail as a matter of law.

26 The claim is essentially premised on Anthem's impermissibly narrow
27 reading of Section 1215.2 and its contention that the Commissioner could not even
28 consider the impact on policyholders of the enormous debt service and executive

1 compensation resulting from the merger. As shown in Section I above, however, the
2 Commissioner was plainly entitled under the statute to consider those effects on
3 policyholders. Whether the Commissioner has "ordinarily" approved other merger
4 transactions after proof of adequate capitalization is irrelevant. It was rational for the
5 Commissioner to consider the huge financial burden that might be imposed on
6 policyholders from this transaction. So long as enforcement of the statute bears a rational
7 relationship to a conceivable legitimate state interest, equal protection is not violated.
8 *Great-West Life Assurance Co. v. State Bd. of Equalization*, 19 Cal.App.4th 1553, 1560
9 (1993).

10 Anthem has not alleged, nor can it, that the Commissioner has previously
11 approved merger transactions that saddle policyholders with responsibility for huge debt
12 and executive compensation obligations without considering those facts. And, even if he
13 had, "[u]nequal treatment which results simply from laxity of enforcement or which
14 reflects a nonarbitrary basis for selective enforcement of a statute does not deny equal
15 protection and is not constitutionally prohibited discriminatory enforcement." *Cilderman*
16 *v. City of Los Angeles*, 67 Cal.App.4th 1466, 1470 (1998).

17 The Commissioner is not required to ignore his statutory mandate when
18 facts are presented that show prejudice to policyholders in this state. Anthem cannot rely
19 on an equal protection claim to force approval of a transaction that the Commissioner
20 determined was detrimental to BC Life & Health's policyholders.

21 Respectfully submitted,

22 ALSCHULER GROSSMAN STEIN & KAHAN LLP

23
24 By 

25 Frank Kaplan
26 Attorneys for Respondents and Defendants
27 John Garamendi, in his capacity as Insurance
28 Commissioner of the State of California and
the California Department of Insurance

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PROOF OF SERVICE

I am a resident of the State of California, over the age of eighteen years, and not a party to the within action. My business address is Alschuler Grossman Stein & Kahan LLP, The Water Garden, 1620 26th Street, Fourth Floor, North Tower, Santa Monica, California 90404-4060. On August 25, 2004, I served a true copy of the within documents:

**MEMORANDUM OF POINTS AND AUTHORITIES IN
SUPPORT OF DEMURRER TO PETITION AND
COMPLAINT**

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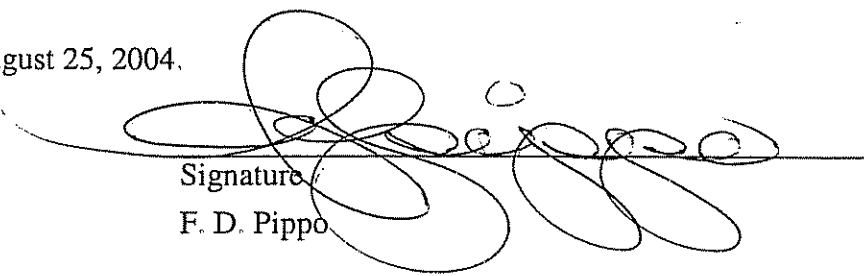
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I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on August 25, 2004.


Signature
F. D. Pippo